Decision **REVISED DRAFT DECISION OF ALJ BUSHEY (Mailed 3/14/2006)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Review Policies Concerning Intrastate Carrier Access Charges.	Rulemaking 03-08-018 (Filed August 21, 2003)

INTERIM OPINION MODIFYING INTRASTATE ACCESS CHARGES

I. Summary

This decision reduces intrastate access charges[1] by eliminating two non-cost based charges - the network interconnection charge (NIC) and transport interconnection charge (TIC). Local exchange carriers are authorized to impose a surcharge on local telephone service to recover lost revenues. Small and mid-sized local exchange carriers are ordered to submit testimony on whether this policy should be extended to them, and include draft rate rebalancing plans.

II. Background

On October 4, 2001, AT&T Communications of California (AT&T) filed a petition pursuant to § 1708.5[2] seeking a reduction in intrastate access charges,

[1] The term "access charges" refers to charges imposed by local exchange carriers for use of the local network by interexchange or long distance carriers, who use this switched access to originate and terminate long distance calls to the vast majority of California residential and business customers.

[2] All section citations are to the Public Utilities Code, unless otherwise indicated.

explaining that existing access charges are priced substantially above cost and stifle competition in long distance markets.

Pacific Bell Telephone dba SBC California (SBC), Verizon California Inc. (Verizon), a group of small local exchange carriers, and Roseville Telephone Company, which has since changed its name to SureWest Telephone, opposed AT&T's petition primarily on the grounds that access charges are set at levels to subsidize local service.

The Commission granted AT&T's petition and found that since setting access charges in 1994, the local exchange carriers had started offering long distance services in direct competition with the long distance carriers, such as AT&T. When providing long distance service, however, the affiliated long distance carriers did not incur access charges but only made paper transfers of such fees to their affiliated local exchange carriers. In contrast, independent long distance carriers incurred charges for access. To the extent access charges exceeded the local exchange carriers' costs, these charges prevented fair competition in the long distance markets because the charge to independent carriers exceeded the "cost" incurred by the local carriers and their affiliates.

In R.03-08-018, the Commission also noted that certain components of the access charges are not cost-based or associated with the costs of any specific transport function, but made no finding whether intrastate access charges were too high to permit long distance carriers to compete with SBC and Verizon in long distance markets. The scope of this proceeding, however, was limited to review of the NIC and TIC components of access charges.

In the decision resolving the first phase of the proceeding, Decision (D.) 04-12-022, the Commission decided that should it authorize local exchange carriers to decrease access charges, these carriers would also be authorized to offset any decrease in access charge revenue with comparable increases in revenue for local services. The Commission also decided to examine mid-size and small local exchange carriers' access charges in a subsequent phase of this proceeding.

SBC, Verizon, and MCI WorldCom Network Services, Inc. (MCI) and Qwest Communications Corporation (Qwest) submitted initial testimony on the Phase II issue of whether the non-cost-based elements of the access charges should be modified. AT&T, Sprint Communications Company (Sprint), Qwest, MCI, and Verizon provided responsive testimony. The Utility Reform Network (TURN) and the Office of Ratepayer Advocates (ORA) jointly filed and served comments responding to the initial testimony.

On November 18, 2005, the Commission approved the application of SBC and AT&T for authority to transfer control of AT&T Communications of California and its related California affiliates from AT&T to SBC, with the resulting entity doing business as AT&T. The merger created the largest telecommunications firm in the United States. Also on November 18, 2005, the Commission approved a similar merger between Verizon and MCI in D.05-11-029. For clarity and consistency of record, we will refer to the merged entities as SBC/AT&T and Verizon/MCI.

The assigned ALJ issued a draft decision resolving all issues in this proceeding on December 19, 2005. Based on comments from the parties, discussed in more detail below, the ALJ's decision was substantially revised and mailed for additional comment on March 13, 2006. Also on that day, President Peevey, the Assigned Commissioner, mailed his Alternate Decision.

III. Non-Cost-Based Elements of Access Charges

Verizon's access charges include TIC and SBC's access charges include NIC. The history and derivation of these charges is discussed in D.04-12-022, and need not be repeated here. No party disputes that these charges are not based on cost, and are assessed on a per-minute basis for all long-distance calls originated or terminated by a local exchange carrier for a third-party long distance carrier.

In D.04-12-022, we also discussed the undesirable effect of excessive access charges on competition where not all market participants are subject to the charges. Changes in California's telecommunications market, namely the mergers of the two largest local exchange carriers with the two largest long distance carriers, discussed above, and the local exchange carriers' entry into the long distance market, have greatly diminished the fraction of the long distance market actually paying the access charge to an unaffiliated entity. To the extent access charges are set above cost, local exchange carriers and their affiliates incur lower costs than independent carriers, which could undermine our goal of a fair and competitive market.

IV. Positions of the Parties

The January 25, 2005, scoping memo listed four issues that would be addressed in Phase II of this proceeding. The parties' positions on each issue are set out below:

A. Whether to reduce or eliminate the NIC and TIC portions of access charges

ORA and TURN oppose eliminating the non-cost-based components of the access charges because the Federal Communications Commission (FCC) is considering revisions to its intercarrier compensation regime which could render unnecessary or be inconsistent with the changes proposed in this docket. ORA and TURN also pointed to the then-pending SBC/AT&T and Verizon/MCI mergers as dissipating the urgency to eliminate the non-cost-based elements of access charges.

All other parties supported eliminating these portions of access charges.

B. SBC and Verizon Revenue from NIC and TIC

No party disputed SBC's and Verizon's representations of NIC and TIC revenue in 2004. The reported amounts are shown below.

	2004 Revenue
SBC	$130.0 million
Verizon	$ 43.2 million

C. Appropriate Ratemaking for Recovery of Lost Revenues if NIC and TIC are Eliminated

Verizon argued that actual data, rather than forecasts, should be used to determine its lost revenue, which would vastly simplify the ratemaking process by removing a significant source of controversy and uncertainty. Verizon proposed to use its Schedule A-38 surcharge as a mechanism to assess the needed revenue increase, $43.2 million, to its local billing base. Verizon noted that the Commission has previously used the Schedule A-38 surcharge as a means to implement similar, minor price changes, including the annual price cap filings and exogenous factor adjustments.

SBC also proposed to use 2004 actual revenue from its non-cost-based access charge element as the amount to be re-allocated to local customers. SBC stated that predicting such lost revenues for future years would be a function of access line market share and consumer calling patterns, which would require a contentious proceeding to resolve. Like Verizon, SBC recommended that its lost revenues be recovered through permanent increase to its Rule 33 Surcharge in the amount of $130.0 million.

Sprint, Qwest, and AT&T took no position on the ratemaking proposals.

ORA and TURN agreed, for purposes of this proceeding only, that actual data rather than forecasts should be used for ratemaking. ORA and TURN, however, opposed SBC's and Verizon's proposal to use 2004 data to permanently increase surcharge revenues.

ORA and TURN stated that SBC has conceded that revenue from the NIC and TIC charges has been declining, and is expected to continue to decline. ORA and TURN opposed locking in 2004 lost revenues in perpetuity. Instead, ORA and TURN propose that the amount decrease by 5% or 10% per year until the amount is zero.

Verizon and SBC opposed ORA and TURN's proposal and contended that revenue rebalancing should be done on a test year basis, and that its local calling base is declining so the actual amount recovered will decline over time.

D. Should the Commission Take Steps To Ensure That Long Distance Customers Receive The Benefit of Lower Access Charge?

With the exception of ORA and TURN, all parties opposed the Commission mandating that long distance companies decrease prices to reflect lower access charges. The agreeing parties contended that the competitive marketplace would provide a better and more efficient means to address these cost savings.

ORA and TURN urged the Commission to require long distance carriers to pass through any access charge reductions to their customers. ORA and TURN argued that without mandated price reductions, the long distance carriers will benefit from these cost reductions, not customers. ORA and TURN pointed out that with the now-approved mergers, the two largest local exchange carriers will absorb the two largest independent long distance carriers, and thus absorb the benefits of the cost reduction. These same local exchange carriers will also benefit from a rate increase to offset the lost NIC and TIC revenues. ORA and TURN concluded that, absent Commission action to require price reductions, this double benefit will occur.

V. Discussion

Fair competition in the long distance market is a long-standing goal of this Commission. Our purpose in opening this rulemaking was to evaluate AT&T's contention that long distance carriers were being subject to a "price squeeze" by local exchange carriers offering long distance service. AT&T argued that independent long distance carriers paid above-cost access charges, while the local carriers' long distance affiliates made only "paper transfers." (See R.03-08-018.) Since that time, however, AT&T has merged with SBC and has, in effect, joined the affiliates of which it complained. Verizon and MCI have similarly merged.

A. Elimination of NIC and TIC

For many well-articulated reasons, all parties agree that access charges should be based on costs, and that the NIC and TIC elements of access charges are not based on costs. As a conceptual matter, no party supports continuing these cost elements, although ORA and TURN recommend that we maintain the status quo pending final actions by the FCC.

We agree with the parties that the NIC and TIC should be eliminated. Ensuring fair competition requires that access charges closely follow actual costs. The NIC and TIC are not consistent with this requirement, and we eliminate this component of access charges.

B. Methodology for Offsetting Rate Increases

In D.04-12-022, we concluded that if we reduce or eliminate access charges for SBC and Verizon, then we should order "offsetting rate increases." (See Conclusion of Law 2.) While dollar-for-dollar offsets were not required, we contemplated a reasonable approximation of on-going revenue deficiencies, consistent with our rate rebalancing history. See, e.g., *Universal Service and Compliance with the Mandates of Assembly Bill 3643*, 68 CPUC2d 524, 630 (D.96-10-066) (ordering local exchange carriers to reduce other rates to offset high cost subsidy amounts, and setting up memorandum account to true up actual amounts).

No party disputes SBC's and Verizon's estimates of 2004 revenues from the NIC and TIC. SBC and Verizon would have this amount added to their respective overall surcharges on an annual basis indefinitely.

The record in this proceeding, however, shows that all parties are adverse to forecasting lost revenue, and that current trends show overall access charge revenue decreasing. To avoid forecasting contentiousness, Verizon and SBC propose to use actual 2004 data. ORA and TURN do not oppose starting with 2004 data, but suggest building in a 5% or 10% annual reduction, which SBC and Verizon in turn oppose.

Due to the significant changes in the long distance market, most notably the mergers, we find that 2004 data is not reasonably representative of the expected future. We also find that a reasonable estimate should reflect the conceded declining revenue from access charges.

Given the unpredictable marketplace, we conclude that developing and adopting long-range reasonable forecasts of lost revenue from eliminating NIC and TIC would require substantial resources of the parties as well as the

Commission. Such expenditure of resources is not justified in light of the amount likely to be at issue.

Therefore, we will adopt a ratemaking methodology that uses actual recorded lost revenue, adjusted for market share reductions, as the basis for making annual forecasts of lost revenue and calculating the annual surcharge. (See Attachment A.)

C. Intra-LEC[3] and Affiliate NIC and TIC Access Charges

Although ordering "offsetting rate increases," D.04-12-022 did not define the exact amounts to be "offset." Instead, the Commission adopted rate rebalancing principles which require that the offsetting process create neither a windfall nor a loss of opportunity for the local exchange carrier to earn its authorized rate of return.

Specifically, the decision did not address the critical distinction between actual payments from independent carriers and the "paper transactions" of intra-LEC and affiliated long distance carriers. Since issuing D.04-12-022, this distinction has gained significance due to the Verizon/MCI and SBC/AT&T mergers discussed above. Today, the merged entities each control a substantial share of the long distance service in their respective service territories, and SBC/AT&T perhaps a majority.[4] Thus, much of the lost revenue from suspending NIC and TIC is now comprised of "paper transfers" from intra-LEC and affiliated long distance companies, rather than actual cash payments from independent entities.

---

[3] We use the "intra-LEC" to refer to SBC's and Verizon's own long distance operations.

[4] The record includes references to SBC's 40% share of the long distance market prior to the merger.

Applying the concept of "offsetting rate increases" for removing the NIC and TIC elements from access charges assessed to independent long distance carriers is straightforward. The local exchange carrier will receive less revenue from the long distance carrier, and this reduction must be made up by a corresponding increase to local telephone rates to leave the local exchange "revenue neutral." The process we adopted above calling for surcharges based on historic NIC and TIC collections, modified for declining markets, achieves this objective.

In contrast, the intra-LEC and affiliate transfers for NIC and TIC raise numerous complexities. Unlike the transfers with independent carriers, reducing these paper transfers has different consequences from reducing actual payments.

Verizon/MCI and SBC/AT&T argue, however, that the Commission resolved this issue in D.04-12-022 by taking comment, and declining to make changes to the draft decision which did not distinguish between the two types of transfers. ORA and TURN dispute this contention and provide quotations showing that the Commission took comment on the issue of whether the local exchange carrier would realize a windfall if the Commission did not order corresponding reductions in long distance rates. No party contends that including affiliate transfers in the lost revenue calculation was analyzed or explicitly addressed in that decision, and the decision contains no findings of fact or conclusions of law on the issue.

Since adopting D.04-12-022, the mergers discussed above have been approved and the share of NIC and TIC collections from intra-LEC and affiliate transactions has increased. These new developments magnify the importance of explicitly addressing and resolving this issue. Accordingly, we conclude that this issue should be addressed.

Although the record is limited, the essential facts are not in dispute. A substantial share of NIC and TIC transfers are intra-LEC or affiliate transfers for both Verizon/MCI and SBC/AT&T. The affiliated entities realize no revenue from these transfers, thus discontinuing NIC and TIC will have no revenue effect on the affiliated entities.[5] Verizon/MCI and SBC/AT&T advocate that we nevertheless recognize a revenue loss for surcharge calculation purposes. Our rate rebalancing principles, as restated in D.04-12-022, establish the goal of creating neither a windfall nor the loss of opportunity for the local exchange carriers to achieve their authorized returns. Verizon/MCI and SBC/AT&T ask that we, in effect, accept a fictional loss as the basis for a very real rate increase[6] for local customers. Including intra-LEC and affiliate transactions in calculating the rate surcharge for local customers has the strong potential to create a substantial windfall for the Verizon/MCI and SBC/AT&T by offsetting a paper transfer with an actual rate increase. Such a windfall would violate our rate rebalancing principles.[7]

We must also consider whether excluding these transfers would result in the loss of opportunity for the Verizon/MCI and SBC/AT&T to earn their

---

[5] In fact, one recognized benefit of telecommunications company mergers is that the merged carriers will not have to pay each other fees to terminate calls on their networks. See Belson, AT&T Aims to Become All Things to All Customers, N.Y. Times, March 7, 2006.

[6] Currently estimated at up to 4% for local services.

[7] ORA and TURN's solution to this windfall would be ordering corresponding reductions in long distance rates such that, overall, Verizon/MCI and SBC/AT&T would be indifferent. This proposal is infeasible because we do not set long distance rates, and impractical due to the variety of factors that may affect the long distance market independently of access charges.

authorized return. Verizon/MCI and SBC/AT&T contend that both independent and affiliate intra-LEC transfers should be treated the same for purposes of calculating lost revenues. Verizon/MCI argued that excluding intra-LEC and affiliate transfers will result in a revenue shortfall because the independent long distance carriers will reduce their prices to reflect the lower access charges, and Verizon/MCI and SBC/AT&T will be forced to follow suit. Verizon/MCI and SBC/AT&T conclude that the losses caused by these price reductions will undermine their opportunity to earn their authorized return.

Consideration of the long distance market, however, calls into question Verizon/MCI and SBC/AT&T conclusions. Removing NIC and TIC will lift a non-cost-based charge effectively imposed only on independent carriers. As discussed above, the Verizon/MCI and SBC/AT&T control much of the long distance market and make paper transfers rather than paying actual access charges such that a substantial share of the prices in the long distance market are currently free of the NIC and TIC cost burdens. Removing the NIC and TIC cost elements for access charges imposed on independent carriers will put these carriers on the same cost footing as Verizon/MCI and SBC/AT&T currently enjoy in setting prices. If, after being relieved of the NIC and TIC cost burdens, the independent carriers are able to reduce their prices below Verizon/MCI's and SBC/AT&T's, these lower prices will be due to other factors, such as efficiency. Our rate rebalancing principles do not require that Verizon/MCI's and SBC/AT&T's opportunity to earn their authorized return be protected from such consequences.

In sum, including intra-LEC and affiliate transfers in calculating the amount to be recovered from local customers creates a substantial likelihood of a windfall for local exchange carriers, and thus violates our rate rebalancing principles. Excluding such transfers cures this violation, and does not materially reduce Verizon/MCI's and SBC/AT&T's opportunity to achieve authorized returns.

Consistent with our rate rebalancing principles restated in D.04-12-022, we, therefore, order that intra-LEC and affiliate transfers be excluded from amount to be recovered from local customers.

The overall long distance market is declining such that Verizon/MCI and SBC/AT&T expect their future collection of NIC and TIC from all carriers to similarly decline. The size of the local market, from which the revenue reductions will be made up, is also declining. As set forth elsewhere in today's decision, we require annual filings to calculate the surcharge on local ratepayers.

D. Local Exchange Carriers Other Than SBC and Verizon

In D.04-12-022, we indicated that we would consider changes to access charges of the local exchange carriers other than SBC and Verizon in a third phase of this proceeding. These non-SBC or Verizon entities include small rural exchange carriers,[8] Frontier companies,[9] SureWest Telephone, and the competitive local exchange carriers. The Commission uses different procedural

---

[8] Calaveras Telephone Company, Cal-Ore Telephone Company, Ducor Telephone Company, Global Valley Network (Evans Telephone Company), Foresthill Telephone Company, TDS-Happy Valley Telephone Company, TDS-Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Company, Ponderosa Telephone Company, Verizon-WestCoast, Sierra Telephone Company, Inc., Siskiyou Telephone Company, Volcano Telephone Company, TDS-Winterhaven Telephone Company, and Century Telephone of Oregon.

[9] "Frontier companies" include Citizens Telecommunications Company of California, Inc., Citizens Telecommunications Company of the Golden State (a small rural exchange carrier), Citizens Telecommunications Company of Tuolumne (a small rural exchange carrier), Frontier Communications Company of America, and Electric Lightwave, Inc.

mechanisms to review the rates and charges for each of these types of entities. The small rural exchange carriers usually file either CHCF-A general rate cases via the advice letter process. Frontier-Citizens Telecommunications Company of California and SureWest have annual price cap filings and review similar to SBC and Verizon. The competitive carriers are not required to provide cost support for their services and have flexible pricing rules.

To consider extending our policy that access charges should exclude non-cost-based elements to the local exchange carriers other than SBC and Verizon, we adopt the following schedule:[10]

May 19, 2006 - Each carrier file and serve testimony identifying and quantifying any non-cost-based elements in current access charges,[11] addressing whether the policy adopted in today's decision should be extended to the specific carrier, showing the local service rate implications of rate rebalancing (with any California High Cost Fund affects), and including any other information the carrier believes will be helpful to the Commission when considering this question.

June 9, 2006 - File and serve any responsive testimony. Any further procedural steps will be set by ruling of the assigned ALJ or Commissioner.

VI. Conclusion

Our primary objective in this proceeding is to assure California long distance markets remain competitive and working to the benefit of California

---

10 The assigned ALJ may alter the schedule as necessary for an efficient proceeding.

11 The competitive local carriers are not required to file cost information.

customers. This order resolves the questions set forth in R.03-08-018 and eliminates non-cost-based rate elements from access charges.

VII. Hearings Are Not Required

No hearings are necessary as there are no disputed issues of material fact.

VIII. Comments on Draft Decision and Revised Draft Decision

The Commission mailed the draft decision of ALJ Bushey in this matter on December 19, 2005, in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure.

Parties filed comments on January 10, 2006. SureWest and the Small LECs[12] raised procedural and substantive objections to the components of the draft decision which addressed local exchange carriers other than SBC and Verizon. That section has been substantially revised for today's decision to reflect the changes requested by SureWest and the Small LECs. ORA and TURN also supported these changes.

Verizon argued that access charges paid by LEC affiliates should be included in calculating a revenue neutral offset rate increase. Verizon stated that excluding LEC affiliates was not supported by the record and was contrary to the Phase I decision. Verizon also contended that the Commission's policy is to treat affiliates and local exchange carrier as separate entities for ratemaking and regulatory purposes. Excluding the affiliate amounts would also violate the

---

[12] Calaveras Telephone Company, Cal-Ore Telephone Co., Ducor Telephone Company, Foresthill Telephone Co., Global Valley Networks, Happy Valley Telephone Company, Hornitos Telephone Company, Kerman Telephone Company, Pinnacles Telephone Co., The Ponderosa Telephone Co., Sierra Telephone Company, Inc., The Siskiyou Telephone Company, Volcano Telephone Company, and Winterhaven Telephone Company.

standard of revenue neutrality because the competitive market would not allow Verizon's affiliates to retain all the benefit of access charge reductions. The affiliate issue is addressed in section V.C. of today's decision.

Verizon also opposed using a memorandum account to track lost revenues because it was a temporary measure that required administratively burdensome annual filings. Verizon pointed out that its local billing base was declining so that using 2004 access charge data to calculate a permanent percentage surcharge would result in similarly declining total revenue.

SBC echoed Verizon comments and pointed out two errors in the draft decision, which have been corrected.

ORA and TURN filed joint comments that continued to oppose rate rebalancing as creating a windfall for the local exchange carriers because the Commission is unwilling to order corresponding reductions to long distance prices. ORA and TURN agreed, however, that using only actual lost revenues from unaffiliated entities would partially mitigate but not eliminate the windfall. They also opposed making the surcharge permanent. ORA and TURN stated that making the LEC "whole" for rate elements not based on costs is fundamentally inconsistent with Commission policies and sound ratemaking principles.

Sprint filed comments supporting the draft decision, and advocating for further reforms of intrastate switched access rates and the intercarrier compensation system.

Verizon replied in opposition to ORA and TURN's comments, and supported the small LEC's. SBC focused its opposition on ORA and TURN's proposal to limit the duration of the surcharge.

In their reply comments, ORA and TURN dispute SBC's and Verizon's assertions that the Commission has previously addressed the issue of including affiliate transfers in the lost revenue tabulation. ORA and TURN provided quotations from the record showing the issue on which the Commission sought comment was whether "reducing access charges and permitting the LEC to make corresponding increases to other rates would provide a windfall to the LEC's family of companies if the long distance affiliate is not compelled to make corresponding rate reductions." ORA and TURN also contended that recording actual lost revenues in a memorandum account did not violate previous Commission decisions, but that Verizon's and SBC's proposal amounted to "making them whole for revenue losses in perpetuity."

SureWest's reply comments supported SBC's and Verizon's opening comments, and the Small LECs observed that ORA and TURN agreed with their request to be excluded from this decision.

Qwest filed reply comments opposing ORA's and TURN's assertion that revenue rebalancing was unnecessary, and stating that revenue neutrality must ensure that no LEC is penalized for the progressive restructuring of intrastate access rates.

The Commission mailed the revised draft decision of ALJ Bushey and the alternate draft decision of Commissioner Peevey on March 14, 2006, in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure.

Verizon/MCI and SBC/AT&T filed comments on the revised draft decision which contended that the lost revenue tabulation should include NIC and TIC transfers from affiliates. The comments argued that excluding such transfers would violate the principle of revenue neutrality. The comments also proposed clarifying revisions to the surcharge methodology set out in Attachment A.

The California Cable and Telecommunications Association (CCTA) supported the exclusion of affiliate transfers in calculating lost revenues. The CCTA argued that to do otherwise would result in a windfall to the incumbent local exchange carriers because they would receive actual dollars for what previously had been a paper transaction.

TURN and ORA's comments also supported excluding affiliate transfers from the lost revenue calculation. TURN and ORA argued that this windfall to the incumbent local exchange carriers harms competition in the long distance markets, and simultaneously extracts unwarranted rate increases from local customers. TURN and ORA also advocated that the lost revenues be reduced by 5 or 10% each year to limit the duration that local customers will be assessed this surcharge, and that competitive local carriers should be excluded from Phase III.

Frontier, SureWest, and small LECs filed separate, although similar comments, which supported the Alternate Draft Decision but suggested that the Commission not act on access charges for other companies until the FCC concludes its review of intercarrier compensation.

CALTEL's comments focused on the next phase of the proceeding and sought to have CLECs excused as respondents and, if not excused, then CALTEL seeks clarification on the purpose of "identifying and quantifying any non-cost based elements in the current access charges." As noted above, CLECs do not set rates based on costs so we will exclude the competitive carriers from the requirement to include cost data in their testimony.

Reply comments were filed by Verizon/MCI, SBC/AT&T, ORA and TURN jointly, and Qwest. Verizon/MCI and SBC/AT&T both argued that ORA/TURN's contention that the draft decisions ensured eternal recovery was erroneous. Verizon/MCI stated that once set, all revenue rebalancing is permanent and not altered should the future unfold differently from forecasts.

SBC/AT&T disputed ORA/TURN's allegation that competitors will be disadvantaged by including affiliate transfers in the lost revenue calculation.

ORA/TURN contended that the anticompetitive impacts of non-cost-based access charges were the premise of this proceeding, and allowing SBC/AT&T and Verizon/MCI to surcharge local customers for paper transfers from affiliates will create excess profits. ORA/TURN supported CCTA's observation that including affiliate transfers in calculating lost revenue violated the Commission's precedent on revenue neutrality.

Qwest's reply comments opposed the small, mid-sized and competitive local carriers' call to postpone phase III of this proceeding. Qwest argued that all local carriers should be required to eliminate non-cost-based rate elements.

IX. Assignment of Proceeding

Michael R. Peevey is the Assigned Commissioner and Maribeth A. Bushey is the assigned ALJ in this proceeding.

Findings of Fact

1. Verizon/MCI's and SBC/AT&T's access charges include rate elements which are not based on cost.

2. The estimates of 2004 TIC and NIC revenues provided by Verizon and SBC are not reasonable forecasts of on-going revenues from these access charge elements.

3. Verizon/MCI and SBC/AT&T account for a substantial share of long distance access minutes in their respective service territories.

4. Intra-LEC and affiliate access charges are paper transactions with no revenue impact to the consolidated corporation.

5. Including intra-LEC and affiliate transactions in calculating the local rate increase necessary to offset revenue losses caused by eliminating NIC and TIC would create the potential for a substantial windfall for Verizon and SBC.

6. Excluding intra-LEC and affiliate transactions will not materially diminish Verizon's and SBC's opportunity to earn their authorized return.

Conclusions of Law

1. No hearings are necessary.

2. The NIC and TIC rate elements of access charges should be eliminated.

3. Verizon and SBC should recover actual lost revenue from unaffiliated entities caused by suspending the NIC and TIC elements.

4. The Commission's objective in rate rebalancing is to create neither a windfall nor the loss of opportunity to achieve authorized returns.

5. The procedural schedule set out above should be adopted for local exchange carriers other than Verizon and SBC.

6. This decision should be effective immediately.

INTERIM ORDER

IT IS ORDERED that:

1. Pacific Bell Telephone Company dba SBC California, Inc. (SBC) shall eliminate the network interconnection charge element of its access charges with an advice letter filing no later than 30 days after the effective date of this decision.

2. Verizon California Inc. (Verizon) shall eliminate the transport interconnection charge element of its access charges with an advice letter filing no later than 30 days after the effective date of this decision.

3. SBC and Verizon are authorized to file the advice letters as set out in Attachment A to implement a surcharge to recover estimated lost revenues from

unaffiliated entities caused by eliminating the rate elements described in Ordering Paragraphs 1 and 2. The initial advice letter may be filed simultaneously with the advice letters authorized in Ordering Paragraphs 1 or 2, with all subsequent advice letters filed annually as provided in Attachment A.

4. The local exchange carriers other than SBC and Verizon shall adhere to the procedural schedule set forth above.

5. No hearings are necessary for this phase of this proceeding.

This order is effective today.

Dated _________________, at San Francisco, California.

Attachment A

Methodology for Calculating Annual Surcharge

No later than April 1 of each year, SBC and Verizon shall file and serve an advice letter, as specified in General Order 96A, or its successor, setting forth the following calculations. The advice letter filing shall include all workpapers necessary to show all calculations and shall reference the source of all data relied upon. SBC and Verizon shall provide prompt responses to any requests from staff for further data.

Calculate the Amount to be Recovered in Surcharge Year

1. Determine amount of annual revenue that would have been realized from carriers as specified in the decision adopting this methodology if NIC or TIC were still in place in previous year. Annual revenue equals recorded annual NIC or TIC minutes of use, multiplied by the NIC rate element ($0.004488) or the TIC rate element ($0.005880).
2. Adjust revenue amount by percentage change in access minutes between previous two years.
3. Adjusted revenue amount is the forecasted amount to be recovered through the surcharge.

Calculate the Surcharge

1. Determine the exchange billing base to which the surcharge will be applied for the previous year.
2. Adjust exchange billing base by percentage change between two previous years.

3. Divide adjusted NIC or TIC revenue by adjusted exchange billing exchange base to determine percent surcharge to recover NIC or TIC revenues.

4. Adjust Rule 33 exchange services surcharge or Schedule A-38 surcharge.

Example Calculation Using Initial Surcharge When NIC and TIC are Eliminated (using methodology described above).

Adjusted NIC or TIC Revenue Calculation

	2005 NIC/TIC MOU
Divided by	2004NIC/TIC MOU
Times	2005 NIC/TIC Revenue
Equals	Adjusted NIC/TIC Revenue

Adjusted Billing Base Calculation

	2005 Exchange Billing Base
Divided by	2004 Exchange Billing Base
Times	2005 Exchange Billing Base
Equals	Adjusted Exchange Billing Base

Surcharge Adjustment

	Adjusted NIC/TIC Revenue
Divided by	Adjusted Exchange Billing Base
Equals	Percent Surcharge to recover adjusted NIC/TIC Revenue

(End of Attachment A)